

EXHIBIT A

opment (AA/MSB&COD) or his or her designee (See § 124.102(b)).

(4) Formal size determinations (§§ 121.1601 through 121.1608 of this part) pursuant to a request therefore by an applicant for any assistance program of SBA not otherwise provided for, adversely affected by a size status finding made by an official of SBA, or by a size status finding made by a participating financial institution or a small business investment company in connection with an application for financial assistance §§ 121.801 through 121.806. Formal size determinations shall also be made by the Regional Office in connection with applications for program assistance upon request by the appropriate program official of SBA, a participating financial institution or a small business investment company.

(b) Except for SBA's small business set-aside program and SBA's Small Business Innovation Research program, formal size determinations shall be made by the SBA Regional Office serving the geographical area in which the principal office of the protested concern or applicant concern, excluding its affiliates, is located. Formal size determinations in the small business set-aside program and SBA's Small Business Innovation Research program shall be made by the SBA Regional Office serving the geographical area of the headquarters of the offeror, regardless of the location of parent companies or affiliates.

(c) The Regional Administrator may request a formal size determination whenever he/she deems it appropriate.

DEFINITIONS

§ 121.401 Affiliation.

(a) *General rule.* (1) Except as otherwise noted, size determinations shall include the applicant concern and all its domestic and foreign affiliates. Moreover, all affiliates, regardless of whether organized for profit, must be included.

(2) Except as otherwise provided in this section, concerns are affiliates of each other when either directly or indirectly

(i) One concern controls or has the power to control the other, or

(ii) A third party or parties controls or has the power to control both, or

(iii) An *identity of interest* between or among parties exists such that affiliation may be found.

(3) In determining whether affiliation exists, consideration shall be given to all appropriate factors, including common ownership, common management, and contractual relationships.

(b) *Exclusion from affiliation coverage.* Portfolio or client concerns owned in whole or substantial part by investment companies licensed, or development companies qualifying under the Small Business Investment Act of 1958, as amended, or by Investment Companies registered under the Investment Company Act of 1940, as amended, concerns owned and controlled by Indian Tribes, or concerns owned and controlled by Alaska Regional or Village Corporations organized pursuant to the Alaska Native Claims Settlement Act (43 U.S.C. 1601, *et seq.*) are not considered affiliates of such investment companies, development companies, tribes or Alaska Regional or Village Corporations.

(c) *Nature of control in determining affiliation.* (1) Every business concern is considered to have one or more parties who directly or indirectly control or have the power to control it. Control may be affirmative or negative and it is immaterial whether it is exercised so long as the power to control exists.

Example. A party owning 50 percent of the voting stock of a concern would have negative power to control such concern since such party can block any action of the other stockholders. Also, the bylaws of a corporation may permit a stockholder with less than 50 percent of the voting stock to block any actions taken by the other stockholders. Affiliation exists when one or more parties have the power to control a concern while at the same time another party, or other parties, may be in control of the concern at the will of the party with the power to control.

(2) Control can arise through stock ownership; occupancy of director, officer or key employee positions; contractual or other business relations; or combinations of these and other factors.

(3) Control can arise through management positions where a concern's voting stock is so widely distributed

that no effective control can be established.

Example. In a corporation where the officers and directors own various size blocks of stock totaling 40 percent of a concern's voting stock, but no officer or director has a block sufficient to give him control or the power to control and the remaining 60 percent is widely distributed with no individual stockholder having a stock interest greater than 10 percent, management has the power to control.

(d) *Identity of interest between and among persons as an affiliation determinant.* Affiliation can arise between or among two or more persons with an identity of interest, such as members of the same family or persons with common investments in more than one concern. In determining who controls or has the power to control a concern, persons with an identity of interest may be treated as though they were one person.

(e) *Affiliation through stock ownership.* (1) A person is presumed to control or have the power to control a concern if he or she owns or controls or has the power to control 50 percent or more of its voting stock.

(2) A person is presumed to control or have the power to control a concern even though he or she owns, controls or has the power to control less than 50 percent of the concern's voting stock, if the block of stock he or she owns, controls or has the power to control is large as compared with any other outstanding block of stock.

(3) If two or more persons each owns, controls or has the power to control less than 50% of the voting stock of a concern, such minority holdings are equal or approximately equal in size, and the aggregate of these minority holdings is large as compared with any other stock holding, the presumption arises that each such person individually controls or has the power to control the concern; however, such presumption may be rebutted by a showing that such control or power to control, in fact, does not exist.

EXAMPLE: Assume that Firms A and B each own 40 percent of Firm C. Assume further that Firm A has 200 employees, Firm B has 400 employees, Firm C alone has 50 employees and that the applicable size standard is 500 employees. This subsection requires that both Firm A and Firm B be considered to in-

dividually control Firm C and that their employees be aggregated with those of Firm C to determine Firm C's size. Therefore, Firm C would be considered other than small because Firm A's employees plus its employees plus Firm B's employees (200 + 50 + 400) would exceed the 500 employee size standard.

(f) *Affiliation arising under stock options, convertible debentures, and agreements to merge.* Stock options, convertible debentures, and agreements to merge (including agreements in principle) are generally considered to have a present effect on the power to control the concern. Therefore, in making a size determination, such options, debentures, and agreements are generally treated as though the rights held thereunder had been exercised. However, an affiliate cannot use such options and debentures to appear to terminate its control over another concern before it actually does so.

EXAMPLE 1. If company "A" holds an option to purchase a controlling interest in company "B," the situation is treated as though company "A" had exercised its rights and had become owner of a controlling interest in company "B." The employees or annual receipts, as the case may be, of both concerns must be taken into account in determining size.

EXAMPLE 2. If large company "A" holds 70% (70 of 100 outstanding shares) of the voting stock of company "B" and gives a third party an option to purchase 50 of the 70 owned by "A" shares of concern "B", company "B" will be deemed to be an affiliate of company "A" until the third party actually exercises its option to purchase such shares. In order to prevent large company "A" from circumventing the intent of the regulation which sells present effect to stock options, the option is not considered to have present effect in this case.

EXAMPLE 3. If company "A" has entered into an agreement to merge with company "B" in the future, the situation is treated as though the merger has taken place.

(g) *Affiliation under voting trusts.* (1) If the primary purpose of a voting trust, or similar agreement, is to separate voting power from beneficial ownership of voting stock for the purpose of shifting control of or the power to control a concern in order that such concern or another concern may qualify as a small business within the size regulations, such voting trust shall not be considered valid for this purpose regardless of whether it is or is not recognized with-

in the appropriate jurisdiction. However, if a voting trust is primarily entered into for a legitimate purpose other than that described above, and it is recognized within the appropriate jurisdiction, it may be considered valid for the purpose of a size determination.

(2) Agreements to divest (including agreements in principle) are not considered to have a present effect on the power to control the concern.

(h) *Affiliation through common management.* Affiliation generally arises where officers, directors, or key employees serve as the majority or otherwise as the controlling element of the board of directors and/or the management of another concern.

(i) *Affiliation through common facilities.* Affiliation generally arises where one concern shares office space and/or employees and/or other facilities with another concern, particularly where such concerns are in the same or related industry or field of operations, or where such concerns were formerly affiliated.

(j) *Affiliation with a newly organized concern.* Affiliation generally arises where former officers, directors, principal stockholders, and/or key employees of one concern organize a new concern in the same or a related industry or field of operation, and serve as its officers, directors, principal stockholders, and/or key employees, and the one concern is furnishing or will furnish the other concern with subcontracts, financial or technical assistance, bid or performance bond indemnification, and/or other facilities, whether for a fee or otherwise.

(k) *Affiliation through contractual relationships.* Affiliation generally arises where one concern is dependent upon another concern for contracts and business to such a degree that its economic viability would be in jeopardy without such contracts/business.

(l) *Affiliation under joint venture arrangements.* (1) A joint venture for size determination purposes is an association of concerns and/or individuals, with interests in any degree or proportion, formed by contract, express or implied, to engage in and carry out a single, specific business venture for joint profit for which purpose they combine their efforts, property, money,

skill and knowledge, but not on a continuing or permanent basis for conducting business generally. The determination whether an entity is a joint venture is based upon the facts of the business operation, regardless of how the business operation may be designated by the parties involved. An agreement to share profits/losses proportionate to each party's contribution to the business operation is a significant factor in determining whether the business operation is a joint venture.

(2) For the purpose of financial assistance to a joint venture, the parties thereto are considered to be affiliated with each other. Where the financial assistance, however, is to a concern for its own use, outside the joint venture, an affiliation determination shall not automatically arise from the existence of the joint venture arrangement. In this latter situation, the existence of affiliation shall be determined under these regulations.

(3) Concerns bidding on a particular procurement or property sale as joint venturers are affiliated with each other with regard to performance of the contract. This determination of affiliation does not extend to other contracts or business outside the joint venture arrangement.

(4) An ostensible subcontractor which performs or is to perform primary or vital requirements of a contract may have such a controlling role that it must be considered a joint venturer affiliated on the contract with the prime contractor. In determining whether subcontracting rises to the level of affiliation as a joint venture, SBA considers whether the prime contractor has unusual reliance on the subcontractor.

(5) Even though a concern might not be an affiliate of its joint venturers for the purpose of operations apart from the joint venture, it nevertheless must include its proportionate share of the joint venture receipts or employees in determining its eligibility under the size standards.

(m) *Affiliation under franchise and license agreements.* In determining whether the franchisor controls or has the power to control and, therefore, is affiliated with the franchisee, the restraints, relating to standardized qual-

ity, advertising, accounting format and other provisions, imposed on a franchisee by its franchise agreement shall generally not be considered, provided that the franchisee has the right to profit from its efforts and bears the risk of loss commensurate with ownership. Alternatively, even though a franchisee may not be controlled by the franchisor by virtue of such provisions in the franchise agreement, control and, thus, affiliation could arise through other means, such as common ownership, common management or excessive restrictions upon the sale of the franchise interest.

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§ 121.402 Annual receipts.

(a) In size determinations where the standard is *annual receipts*, size eligibility requires that the concern may not exceed the *annual receipts* in that standard.

(b) *Definitions.* For the purpose of determining annual receipts of a concern:

(1) *Accrual basis* means a method of accounting in which accounts and notes receivable are recorded in the regular books of account for the period in which the firm first has a claim of right to them. *Claim of right* has the meaning attributed to it by the U.S. Internal Revenue Service (IRS).

(2) *Receipts* is defined to include all revenue in whatever form received or accrued from whatever source, including from the sales of products or services, interest, dividends, rents, royalties, fees, or commissions, reduced by returns and allowances. However, the term *receipts* excludes proceeds from sales of capital assets and investments, proceeds from transactions between a concern and its domestic and foreign affiliates, amounts collected for another by a travel agent or real estate agent, and taxes collected for remittance to a taxing authority.

(3) *Regular books of account* means the general ledger or other book of final entry and, if used, the journals or other books of original entry.

(4) *Completed fiscal year* means a taxable year including any short period. *Taxable year* and *short period* have the meaning attributed to them by the IRS.

(5) Unless otherwise defined in this section, all terms shall have the meaning attributed to them by the IRS.

(c) *Period of measurement.* *Annual Receipts* of a concern which has been in business for 3 or more completed fiscal years means the arithmetic annual average revenue of the concern over its last 3 completed fiscal years (total revenue compiled over the entire 3-year period would be divided by three). *Annual Receipts* of a concern which has been in business for less than 3 fiscal years means the arithmetic annual average revenue over the time period the concern has been in business. (Total revenues compiled over the period the concern has been in business, divided by the number of weeks, including fractions of a week, the concern has been in business, multiplied by 52). *Annual receipts* of a concern which has been in business three or more years but has a short year in the last three years will be the arithmetic annual average revenue over the two full years and the short year. See paragraph (d)(3) of this section. The short period may appear at the beginning, middle or end of the three year calculation period.

(d)(1) *Method of determining annual receipts.* Revenue may be taken from the regular books of account of the concern. If the concern so elects, or has not kept regular books of account, or the IRS has found such records to be inadequate and has reconstructed income of the concern, then revenues shown on the Federal Income Tax return of the concern may be used in determining annual receipts. Subject to the exception in paragraph (d)(2) of this section, revenue shown on the regular books of account or the Federal Income Tax return on a basis other than accrual must be restated to show revenue on an accrual basis for all fiscal years beginning on or after January 1, 1990. For purposes of either a self-certification as to size made, or any size determination initiated or completed, subsequent to January 22, 1992, a firm may elect to show revenues for fiscal years beginning prior to January 1, 1990, on either a cash or an accrual basis of accounting. Further, where the completed contract method of determining income has been used, revenue must be restated to a percentage of completion